- o In-migration, providing services to foreigners who are temporarily residing in the exporting country. These include hotel accommodations and meals, education, and medical treatment.

- o Out-migration, or travel of individual producers to an importing country. This includes services provided to foreign clients by business consultants, engineers, lawyers, and so forth. Many of the services transacted in this manner are provided through foreign affiliates, either by choice or to circumvent barriers to direct imports.

Barriers to Trade in Services

For the government that wants to protect domestic service firms from foreign competition, the particular means of trade used by various service providers create both obstacles and opportunities for action. Although they may not be directly aimed at limiting imports, the most common barriers that restrain trade in services include restrictive regulations and standards, employment rules such as citizenship and residency requirements, investment-related rules such as right-of-establishment requirements and operating/ownership restrictions, foreign exchange and credit controls, and inadequate protection for intellectual property. The following sections discuss how these barriers are used to block trade for each class of service.

Cross-Border Transactions. Cross-border transactions are conducted in much the same manner as goods trade except that the movement of goods, passengers, or messages in itself constitutes the service traded. Thus, cross-border transactions provide the widest scope for protective government actions, and at the same time for government agreements to limit or define acceptable restrictions. Trade in the telecommunications and transportation industries, for example, is generally limited by government regulation, and the rights of firms to engage in cross-border transactions are generally established in bilateral treaties between countries.

Many of the services included in cross-border transactions--notably communications and transportation--enter markets where there are long-standing government interests and regulations. Domestic transportation and communication systems in most countries are either controlled or owned by the government, and foreign firms are generally prohibited from providing domestic services. In many instances, regulations and restrictions are designed to achieve certain social goals such as national security or to bring about economies of scale, rather than merely to shield public communication monopolies from international competition, although this may also be a factor. In some cases, regulations are justified by the need to limit the use of scarce resources and provide for public safety.

Some services are already regulated in international commerce. For example, the rights to transport people and goods are established by bilateral international agreements. Frequently, these agreements limit the routes that can be operated between the two countries. They also often place limits on the number of carriers that can operate between the countries and give governments the ability to regulate fares. Foreign carriers are generally prohibited from providing domestic transportation, and severe restrictions are placed on a carrier providing transportation between two foreign points. Additional restrictions are sometimes placed on foreign airlines operations. These include requiring airlines to use existing baggage-handling facilities and to assure nondiscriminatory access to the domestic carriers' reservation systems.

Contractual Agreements. Contractual arrangements generally involve intangible output in the form of ideas and know-how, although leasing of film, broadcast, and recording rights is also included. The common characteristic shared by these services is that they are transmitted internationally through legal arrangements.

Many of these arrangements involve intellectual property. Many U.S. firms complain that they are accorded inadequate copyright and trademark protection in other countries. [5] This problem arises mainly with newly industrialized countries such as Korea, Brazil, and Singapore. [6] Several of these countries are not members of either the Universal Copyright Convention or the Berne Convention, so foreign firms are not automatically protected against piracy and counterfeiting in these countries. [7]

While copyright infringement is not a barrier to trade in and of itself, it amounts to a loss of exports. For example, the U.S. publishing industry estimates that 1984 sales of unauthorized copies of books and technical journals in Korea were approximately $70 million, while authorized imports were only $5 million to $8 million. [8] The United States recently signed a

5. See Chapter III on high-technology trade.

6. Office of the United States Trade Representative, *National Trade Estimate: 1986 Report on Foreign Trade Barriers*, pp. 35, 171, 227.

7. The United States abides by the Universal Copyright Convention, but not the Berne Convention. See Chapter III.

8. Office of the United States Trade Representative, *National Trade Estimate: 1986 Report on Foreign Trade Barriers*, p. 171.

bilateral agreement with Korea that will protect American firms against trademark and patent violations and open Korean insurance markets to U.S. firms. Despite heavy lobbying efforts on the part of the computer manufacturing industry, the agreement did not cover the computer software industry. It allowed Korea to enact a separate law covering computer software that is expected to be consistent with copyright protection.

Similarily, adequate trademark protection is essential to businesses involved in franchising. Franchisors frequently have difficulties conducting business in a country if their emblem or organization symbol has been previously registered as a mark in that country. Private registration effectively limits foreign access to domestic markets. Franchisors may also run into ownership or foreign investment restrictions, and regulations restricting the repatriation of profits.

Motion pictures or television are often leased for transmission in foreign countries. These services also embody a form of intellectual property, and at the same time face some unique barriers because of characteristics they share with goods. They may enter countries much as do goods, and may in fact be embodied in goods. A movie or television show that entered a country on film or videotape would be a good, but if it entered only for lease, the leasing of it would be considered a service. One that entered via satellite transmission would also be a service.

The close connection between motion pictures and goods trade is emphasized by the fact that the GATT (in Article 4) explicitly recognizes that countries may regulate foreign films, and maintain quotas on them. It limits such regulations to screentime quotas that may require a certain percentage of films exhibited to be of national origin. Such quotas, which are used by many countries to limit the showing of American movies and television shows, are open for negotiation or limitation under the GATT.

<u>In-migration and Out-migration</u>. As previously noted, most services require interaction between provider and consumer. Some services involve the movement of people across national borders. In some far-flung service industries, such as computer consulting and engineering, local on-site offices are necessary to provide the service. These service industries face a unique set of barriers.

Services traded through in-migration primarily provide travel, tourism, and educational services in which the consumers travel to the exporting country. Domestic firms face minimal, if any, trade restrictions on these kinds of services.

Services traded through out-migration, such as accounting and engineering, are provided by professionals with special expertise who must be present wherever the service is marketed. Thus, primary barriers to trade serve to restrict the ability of producers to set up professional practice in the importing country. Typical barriers include the requirement of work permits for professional and technical personnel; the stipulation of minimum percentages of local employees; hiring restrictions or quotas; and citizenship or licensing requirements for foreign engineers, lawyers, and other professionals. Other more rigid barriers such as outright bans or quotas are enforced by some countries in specific industries. For example, American lawyers may not open law offices in Japan or consult indirectly on American or international law through existing Japanese law firms. 9/ In Brazil all foreign firms providing technical services, particularly in construction, are barred unless it can be shown that no Brazilian firm is able to perform the equivalent service. Moreover, all technical service contracts in Brazil must be approved by the Industrial Property Institute, where substantial delays are typical. 10/

More generally, firms relying on out-migration may encounter national policies restricting migration, investment, and conversion of currency. Investment and right-of-establishment laws are important barriers because they require providers of many services to establish local facilities in order to compete. Immigration laws must be reckoned with because a company needs people familiar with its operations to staff these facilities initially and to train local labor. Finally, a firm must be able to repatriate its earnings, which will bring it up against currency control provisions.

According to the Office of Technology Assessment report cited above, over half of all service export earnings come from sales through foreign affiliates. In 1983, for example, nonbanking business services produced by U.S. firms (domestic or affiliates) were estimated by OTA to be in the range of $152 billion to $169 billion. Affiliate sales were estimated at $87.5 billion to $97.3 billion; direct exports were an estimated $61 billion to $75.1 billion. Services in which affiliate sales bulked largest were: account-

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9. In May 1986, Japan approved legislation to open its system to foreign lawyers on April 1, 1987. The effectiveness of the new law remains to be seen. Loc. cit., p. 157.

10. Recently, grievances of this nature have also been expressed with respect to Japan. The U.S. Trade Representative's Office is pressing an unfair trade practice case against the Japanese for denying U.S. firms an "opportunity" to bid on an $8 billion airport construction project in Osaka. According to administration officials, Japanese procurement practices have totally excluded U.S. firms. Ibid.

ing, advertising, data processing, engineering, insurance, investment banking/brokerage, leasing, and retailing.

Exisiting U.S. Agreements

At present, there is no comprehensive and coherent system of rules governing both service trade and investment. Various sectoral agreements, mechanisms, and organizations exist that govern trade on a bilateral or multilateral basis. Many of these are specific in nature, regulating trade between partners in a particular industry. Others are more inclusive, providing standards of treatment with respect to the establishment and operation of foreign business partnerships in various industries. Existing U.S. investment agreements tend to be of the latter nature: multisectoral and bilateral. In contrast, U.S. service trade agreements tend to be unisectoral and multilateral.

The broadest and longest-standing of bilateral agreements are the Treaties of Friendship, Commerce and Navigation (FCN). These were designed to establish a framework for mutually beneficial economic relations between two countries, and emphasize investment issues such as the right of establishment. Currently, the United States is party to FCN-type treaties with 43 nations, most signed in the late 1960s.

More recent are the Bilateral Investment Treaties (BITs), which cover investment issues in four main areas: national and most-favored-nation treatment for investors; standards for compensation in the event of expropriation; provisions for the transfer of profits and other funds associated with investments; and procedures for settlement of disputes. 11/ BITs generally apply to all industries in the merchandise and service sectors, but usually include escape provisions for exceptional industries. To date, the United States has signed such treaties with three countries--Panama, Egypt, and Senegal--and has reached preliminary agreements with Haiti and Costa Rica. Negotiations are under way with 11 other countries.

Bilateral agreements applying only to U.S. service trade are few and involve specific industries requiring special equipment or facilities for conveying services from one country to another. These agreements are designed primarily to ensure technical and regulatory compatibility in industries such as aviation, shipping, and telecommunications.

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11. These treaties were discussed in a study submitted to GATT by the U.S. government, *U.S. National Study on Trade in Services*, p. 41.

Agreements in service trade are for the most part multilateral, and operate through international bodies and organizations. All such agreements are sector-specific. In several industries more than one agreement is necessary to cover adequately all the issues involved in trading that service.

On a more informal level, the Organization for Economic Cooperation and Development (OECD) has attempted to liberalize trade in services and investment through its Code of Liberalization of Current Invisible Operations and its Code of Liberalization of Capital Movements. Both codes commit members of the OECD to abolish restrictions on long-term capital flows and barriers to invisible transactions and transfers, although neither code is strictly enforceable. The Invisibles Code applies explicitly to only a limited set of service industries, although most others are indirectly covered. For instance, education and franchising are not explicitly listed but many aspects of both are covered under generic headings such as profits remittances. Moreover, both the Invisibles Code and the Capital Code lack provisions regarding issues of consequence to service trade such as the right of establishment, the right to conduct business, and national treatment. Although these topics are expected to be incorporated into the Capital Code shortly, as of now it is mainly concerned with capital flows for both manufacturing and services.

BARGAINING POSITIONS IN THE URUGUAY ROUND

The United States has been the leading advocate of negotiations to expand the GATT to cover services. The European Community and Japan favor this in principle, but have been reluctant and unsure. Third-world countries have been opposed to discussing services liberalization because they see little gain in such negotiations.

The European Community

The governments of the EC began only recently to recognize services as an integral part of their economies, and to appreciate the importance of the financial and tele-informatic sectors to future growth. They have already engaged in multilateral talks, both among themselves and with the United States, to liberalize certain aspects of services trade. The OECD codes and the numerous bilateral investment treaties are the results of such talks.

The EC agrees with the United States, in principle, that the GATT should cover services, but has not taken a firm stance on specific conceptual issues such as whether agreements should cover all services or only specific subindustries such as insurance, banking, and telecommunications. To some extent, its negotiating position seems to be a response to that of the United States: if the United States has so much to gain by services liberalization, the European Community may have a lot to lose and therefore has reason to proceed cautiously.

The EC has indicated, however, a willingness to reduce present quantitative restrictions on some Japanese goods if the Japanese make reciprocal concessions in insurance, finance, and management consulting. This offer has also been extended to several of the newly industrializing countries.

Japan

The Japanese also appear to support the notion that GATT should include services, but are reluctant to seek any change in the status quo because of the concessions that will be required. They have experienced very rapid growth in recent years in the financial services sector, and might gain from an agreement specifically targeted at financial services. But they have been hesitant to push toward any specific position on services generally, appearing to want to wait and see what kinds of tradeoffs may be involved.

Developing Countries

The developing countries are opposed to including services in the next round.[12] A frequently stated position is that the existing merchandise agreement has been a failure in many ways, and efforts should be made to strengthen it before expanding its coverage. Underlying this is the belief that the developing countries have little to gain and much to lose in services negotiations, since they do not have service industries that are sufficiently developed to be competitive in a world market. Significant reductions in their service barriers would open their domestic markets to foreign penetration. The governments of these countries face strong political and cultural pressure to protect vital domestic service sectors, such as banking, telecommunications, and professional services.

12. As with nearly all issues, the developing countries are not likely to put forward a unanimous position. Some, such as Singapore and Hong Kong, may be agreeable to developed-country positions; most, however, will oppose them.

Moreover, the developing countries have little confidence that the industrialized countries will open their markets significantly in sectors such as textiles and steel, or even in labor-intensive services such as agricultural fieldwork or construction where developing countries may have a comparative advantage. They fear that negotiations over services could end in an agreement linking services trade to goods trade in such a way as to allow developed countries to retaliate against developing countries' goods exports in response to what are perceived as barriers to developed countries' services exports. In short, they see themselves losing in services negotiations because this is an area in which they are not competitive, and in which they may be penalized by the developed countries if they try to become so.

IMPLICATIONS OF LIBERALIZED TRADE IN SERVICES

A liberalization of trade in services would involve costs as well as benefits to the United States. For example, an increase in service exports would require domestic firms to hire foreign factors, so that the gains to the U.S. balance of trade might be substantially less than the increase in gross overseas sales. Also, relaxing barriers to service trade could invite a substantial increase in the services offered by foreign firms in the United States. Freer trade in services would be likely to require adjustments in U.S. rules regarding immigration, investment, currency conversion, and other forms of commercial regulation. This section examines some implications of trade liberalization in services.

Expansion of Services Trade

In general, the benefits to the U.S. economy from trade liberalization would be the same for services as for goods: the realization of greater efficiency through specialization in areas of comparative advantage. Since many service industries employ the same resources--notably, specialized labor and capital--that have sustained U.S. competitiveness in other products, and because many U.S. service firms already dominate international markets, it is reasonable to assume that some of these industries would expand under a liberalized trade regime. Such services include (among others): most of the highly skilled professional and business services, air transport, telecommunications, and financial services.

Liberalization would allow service firms to expand more rapidly than they would otherwise; it would also draw more new firms and resources into the service sector. As a result, the U.S. economy would become even more service-oriented than it is now. In the past decade, over 90 percent of new job growth has been in the service sector. Under trade liberalization, service firms would also have greater access to the capital neccessary to sustain their growth.

Some of the growth in the service sector would be a net addition to the economy, but some would be at the expense of goods production. Goods-producing industries, however, might also receive ancillary benefits to the extent that they are tied closely to service output. Such industries include those supplying the service sector with computers, aircraft, telecommunications equipment, and the like, and those having tie-ins to services, such as producers of industrial equipment that U.S. engineers and other business consultants may recommend or prefer to use when they operate overseas. Moreover, many diversified firms have direct links between their service and manufacturing activities, resulting in joint sales.

Removal of service trade barriers might not, however, be as beneficial for the U.S. economy, or even for certain service industries, as at first appears. In cases where services are traded through out-migration, particularly where investment is a necessary requirement of doing business, much of the gain from trade leaks to the importing country. This is because service production tends to rely more heavily than merchandise production on local factor inputs, notably labor. Employment data based on U.S. investment overseas indicate that foreign subsidiaries of U.S. firms predominantly rely on local rather than U.S. labor. 13/

Thus removal of service trade barriers might not benefit the U.S. economy as much if liberalization led U.S. firms to increase sales through overseas affiliates rather than through direct exports. This could occur if trade negotiators focused on liberalizing investment regulations but failed to make progress on issues such as immigration rules or other regulations that are closely tied to direct cross-border transactions.

Moreover, liberalization would offer foreign firms a more favorable climate in the United States, where many obstacles to foreign penetration of service fields now exist. For example, liberalization would imply a relaxation of immigration laws to allow freer access for foreign producers to

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13. Although data were only available for majority-owned nonbank affiliates, it is highly probable that affiliates that are not majority-owned also hire fewer U.S. citizens than majority-owned affiliates. Department of Commerce, *U.S. Direct Investment, 1982 Benchmark Survey Data*, p. 251.

U.S. markets. In that case, construction firms in low-wage countries might find it easier to bid on domestic construction projects. Similarly, foreign accountants might be able to provide basic bookkeeping and auditing functions more cheaply than domestic firms. Significant increases in service imports might result, given the large supply of both skilled and unskilled workers from more populous developing countries who would be able to earn higher wages in the United States than at home.

Liberalization of trade rules for services may raise issues of federalism. State governments are responsible for regulating and licensing many service activities, particularly in such fields as banking, accounting, insurance, and legal services. The federal government may not be able to negotiate binding international agreements governing trade in these areas without impinging upon traditional state authority. U.S. trading partners are certain to want clarification of the issue of federal-state authority over services before joining in agreements.

Strategies to Include Services in the GATT

When the GATT was drafted at the end of World War II, services were not seen as important in international commerce. Negotiations focused instead on lowering the primary barriers to goods trade: on multilateral tariff reductions, quota restrictions, and dumping regulations. Consequently, with the single exception of the motion picture industry, GATT rules do not apply explicitly to service industries; they extend to them only insofar as services are involved in the production or trade of goods.

GATT could be altered in several ways to include the service sector. First, the existing rules and principles governing goods trade could be applied to services trade in their existing form--that is, by counting all practices that violate GATT in goods trade as violations in service trade. Dispute and settlement procedures designed to address unfair practices in goods trade would apply in the same manner to services trade. This option would not require elaborate negotiations; it would take advantage of the existing binding, contractual nature of GATT provisions. Only matters pertaining to services, such as investment and immigration, would have to be added to the GATT provisions. On the other hand, many GATT provisions are not directly applicable to services trade, and would not adequately deal with unfair trade practices. Moreover, use of the existing GATT provisions would probably not affect all countries equally, giving some an incentive to evade the rules.

Another approach would be to address services trade on an issue-by-issue basis through dispute-settlement procedures similar to those currently in place in the GATT. Complaints concerning unfair tradé practices in services would then be addressed under GATT auspices, leaving the other existing agreements and treaties in force. This approach would enable the GATT to deal with the service sector a bit at a time, addressing each specific industry separately. Given the varying prospects for growth in different service industries, many people believe this is a much more practical approach and one that would hasten negotiations tremendously. Its primary drawback is that it would not create a unified, comprehensive services trade policy that would be viable for years to come. Moreover, it would overburden an already inadequate dispute settlement process.

Finally, a new service-oriented set of rules and procedures could be designed and negotiated under the GATT framework. This option would be viewed by many negotiators as too radical and costly, requiring long negotiations and research. They would argue that current grievances need to be addressed in a timely manner, rather than waiting for a whole new set of rules. Proponents believe, however, that existing GATT articles cannot be directly applied to service industries as a whole, for conceptual reasons. Negotiating a service-oriented set of articles would extend to that sector the basic tenets embodied in the GATT, and would make them binding upon all parties.